

Development Options

A Primer for Co-op Members

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We Need More Housing

We have a problem. Our Co-op is full. We have long waiting list, and everyday more people are the calling looking for housing. Some of our best members are moving out and buying houses. What can we do? We need more units. We need to expand.

This Primer won't tell you how to develop a new housing co-op. There isn't any magic formula. But it will answer some of your questions, and give you ideas that you can use if you want to expand.

Where did this Primer come from?

Colandco is the land trust set up the Co-operative Housing Federation of Toronto in 1986. Colandco holds the land for thirteen co-ops. Over 2,500 units of housing have been built or renovated by these co-ops. Colandco has always been involved with development. Colandco's board wanted a primer that Co-op members could use to focus their discussion of development options. The Primer was written by Jon Harstone, Colandco's manager, who has over 20 of experience developing affordable housing, with and without government assistance.

Please give us your comments on this primer.

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Will the New Housing be Affordable?

Building housing and making it affordable are two different things.

When someone asks if the housing is going to be affordable, what they usually mean is - will there be any rent-geared-to-income units? Money for rent subsidy comes from the government. In the past, getting approval for a new co-op meant that the project got rent subsidy. Developing new housing and getting rent subsidies used to go hand-in-hand.

Today the process is very different. There is no longer any government assistance to build new co-ops, but it is possible to get rent subsidy. There are several non-profit co-ops that were developed without any government assistance. Some of these co-ops have negotiated a 'contract' to provide rent subsidy for their members.

The first step is getting the housing built. The biggest challenge is developing a project where the housing charges are below market. Once you know that the housing will be built, you can work on making it affordable. Getting rent subsidy is discussed at the end of this Primer.

Why aren't new Co-ops being built?

It's too expensive. Without government assistance, the housing charges for a new unit are higher than the market rents the Co-op can charge. The following example is for a two bedroom apartment in the Toronto area.

Capital Costs	\$100,000 per unit
Mortgage payment (6.5% for 25 years)	\$670 per month
Operating Costs	\$350 per month
Total Costs	\$1,020 per month plus utilities

Nobody is going to pay this much for a two-bedroom apartment.

Remember: All rental housing built since the Second World War have been subsidized by the government in one way or another. Private developers used a number of government programs, including tax credits (such as Capital Cost Allowances and MURBs) to bring down the costs. Non Profit projects use government grants and operating subsidies.

What makes it so expensive?

The total costs are too high. To get housing charges below market, you have to reduce the capital costs by 25% to 30%.

- Land is only 10% to 15% of the costs, so free land won't make the project work.
- The builder's profit is usually 5% of the construction costs. This is about \$3,000. Squeezing the builder won't make the project work.
- CMHC charges a 5% mortgage insurance fee. Eliminating the insurance fee won't make the project work, but it is a big saving.
- New construction is very expensive. New construction co-ops were developed because the Government wanted new housing built. Buying and renovating an existing building is a more cost effective option than new construction.
- A lot of new co-ops are apartment buildings. It costs more to build a concrete building with an elevator, especially if you have to provide underground parking. The most-cost effective projects are townhouses using wood frame construction.
- Red tape and government regulations add to the cost. Architects and builders charge more because of the extra work involved filling out forms for CMHC or the Ministry of Housing. The government's insistence that builders be bonded, and that everything be tendered, has increased the

costs.

Its not just the capital costs that are too high. Operating costs are also part of the problem. Co-ops cost more to operate than private developments. Co-op members expect a higher level of administration and maintenance. In addition, Co-ops put money into a reserve fund. This all adds up to making new co-op projects very expensive.

What about using volunteers? Will that help?

There is a long tradition of co-op members building their own units. Building Co-ops, where the members co-operatively built the entire project were common in the 1940's and 1950's. However, increased municipal standards have made it very difficult for unskilled members to do the work and get it approved. Many people do not have enough spare time to build their own home, and the longer it takes to build the house the higher the interest costs.

Allowing the future residents to co-operatively build their own homes is an option that will work in certain circumstances. It requires enormous commitment and technical skill from the

If you are seriously thinking about having your members build their own units, you should get a copy of CMHC publication NHA 6825 *Housing Ourselves Affordable: A Guide to Affordable Housing Through Collective Self-Help.*

members. But it is not a solution for everyone.

What Can We Do?

There are things you can do. It starts with your membership. You need a committee to animate the community (both the co-op community and the neighbourhood). You have to get the membership excited about and committed to the idea of expansion.

The committee has to be creative and explore options which at first glance appear to be crazy. Otherwise you will be stuck in the same rut, and nothing will happen. Consider getting an outside facilitator.

One of the first things to figure out is who will live in the new units. The housing you develop for members who are moving out because they need larger units is different from the housing you will provide for seniors. Without government assistance, marketing the units is very important. You have to make sure that there is a need and a demand for your new units.

You should look at what is being done elsewhere. There are co-ops being built without government assistance. Many of these co-ops are developed by the economic development department of the local municipality! They are usually equity or limited equity co-ops. They often house very low income families without any rent supplement. They use sweat equity and a variety of community resources and government programs to get the housing built.

It is worth looking at the co-op projects assisted by Rooftops. Canada is now a third world country when it comes to affordable housing, and the way housing is developed in Africa is relevant to Mike Harris' Ontario.

Community and Political Support

Affordable housing is a community issue. You have to convince the community that co-ops are the best way to provide affordable housing, and then support you in your fight to get funding and approvals.

In 1974, David Crombie, when he was mayor of Toronto, flew to Ottawa to lobby CMHC to get funding for two co-ops in Toronto. You need this kind of political support to get a new co-op built.

You have to build alliances with our natural allies: the faith community, the credit union movement, the co-operative movement and the labour movement.

Before there was government assistance to build new co-ops, the United Church had a \$200,000 revolving loan fund that helped the development of new co-ops built under the Limited Dividend Program - (This program required the co-op members to make in a 5% down payment.)

Getting new housing built requires strategic alliances and strong political support.

Using Your Co-op's Resources

To get the project off the ground your co-op must be prepared to spend money. At least \$25,000 will be needed, and perhaps even more. If your Co-op is not prepared to pay for the upfront development costs, then they are not serious about getting more housing built.

Most of the cash your Co-op has in the bank are restricted funds; that means that they are earmarked for certain things (such as future replacements). However, you can use your contributed surplus, operating surplus and member loans to help with the new development. But you have get the members approval first.

The Co-op can do more than provide funds. There may be some extra land that can be developed. The Co-op's lawyer can be asked to donate his services with the understanding that he will get paid if the project proceeds. Your Co-op's auditor can help with financing.

Some older Co-ops have paper equity that can help finance the project. Paper equity is the difference between the value of the existing project (if you could sell it), and the outstanding mortgages. A bank can use the paper equity to provide a loan for the new project. CMHC's permission is required to use paper equity.

Development Assistance

There are sources of financial assistance. However, in order for your application to be taken seriously you have to have a site, and a preliminary design. (In other words, you have to spend money and do the preliminary development work to prove your project is viable before you can get any assistance.)

1. CHFC Risk Underwriting Fund (RUF)

The Risk Underwriting Fund will make loans of up to \$75,000 to assist the development of new co-ops.

2. CMHC Preliminary Development Funding (PDF)

CMHC will provide a forgivable loan of up to \$45,000 to help with the development of affordable housing. The PDF program was set to assist the development of new seniors' housing projects. Five years ago the program was expanded to include family housing.

3. Municipalities

Some municipalities are assisting the development of affordable housing, with grants, loan guarantees and/or technical assistance. For instance, the City of Toronto agreed to guarantee a second mortgage for the West Lodge Co-op Conversion proposal.

Finances

Getting financing for a project is difficult. Here are some things to be aware of:

1. Appraised Value and First Mortgages

The Bank Act restricts the amount of a first mortgage that a bank or credit union can make to 75% of the appraised value of the project. Appraisers treat co-ops as rental projects, and the appraised value is significantly less than the capital costs.

Capital cost	\$100,000 (2 bedroom apartment)
Appraised value	\$60,000 x 75% = \$45,000

First Mortgage \$45,000

If you can only borrow \$45,000 using a first mortgage, then you have to find \$55,000.

You can get CMHC mortgage insurance. With a CMHC guarantee, the bank can lend up to 85% of the appraised value - up to \$51,000 - but CMHC charges a 5% fee. The fee is calculated on all the financing required. If you are going to borrow \$100,000 then CMHC's fee is \$5,000.

2. Second Mortgages

The Bank Act makes it difficult for banks and credit unions to provide second mortgages for a new co-op.

This means that you will have to work hard to find the rest of the financing you need. Potential lenders include the faith community, and social investment organizations. It is not uncommon for limited equity co-ops in the United States to have as many as ten different lenders.

Co-op members can also lend money to the project. It is possible to use RSP funds through a self-directed plan. In a limited equity co-op, the members make a member loan which reduces the amount of mortgage financing needed.

3. Interim Financing

The project has to be under construction for a couple of months before funds are available from the first or second mortgage. You need interim financing to cover the development costs and the first few months of construction have to be covered using some sort of interim financing.

There are a number of venture capital funds willing to lend interim financing for new co-ops. They charge up to 25% for interest, and have a very high application fee (often over \$20,000). In order to avoid dealing with one of these funds, you should arrange interim financing well in advance.

Affordability

Although there is no funding to help projects get built, it is possible to get rent supplements. Rent supplements can be delivered directly to a project using ‘contract placement. This involves having a contract with the government to provide subsidized housing. Hundreds of private landlords have taken advantage of this program, as have the co-ops which were developed without government assistance.

Unfortunately, the downloading of housing to the municipalities means that no one is sure who is responsible for approving new applications. Once housing is clearly a municipal responsibility, you will be able to negotiate new rent supplement units directly with the city.

The other source of rent supplements is the Ministry of Health. If your Co-op has any supportive housing then the Ministry of Health could provide the rent supplements. One way to proceed is build new units for members needing supportive housing, and get the Ministry of Health to provide subsidies. This would free up subsidies in the rest of the Co-op.

You should wait until your project is a go before approaching the government about new rent supplements. You should not count on the subsidies coming through, and you should not base the financial viability of your project on the availability of rent subsidies. Although subsidies are available, they are not easy to get. It takes enormous political pressure and strong community support to get rent subsidies for your project.

Appendix I

Suggested Development Program

Every project is different. The Co-op's members and the future residents will set the program. However, paying attention to the following suggestions will keep the costs down, and improve your project's chance of actually being built.

1. Keep it Simple:

- Wood frame construction (preferably townhouses)
- avoid underground parking
- avoid stacked units and concrete construction

2. Keep it Small:

- Limit the project to between 5 and 10 units

3. Focus on Marketability

- The members who will live in the project should be identified as soon as possible (at least 50% of the future residents must be approved prior to construction starting). These members must be consulted at all stages about the design to ensure the project meets their needs and that they will move in.

Appendix II

Development Terms

The following is a brief glossary of some of the technical language which you may run into.

Blanket Mortgage: This is a large mortgage on all the units in the co-op.

Bonding: Bonding is like insurance. If the builder can't finished the project the bonding company will do it. Sometimes the bonding company will pay to rectify deficiencies (but don't count on it). Most lenders require the builder to be bonded.

Building Co-op: During the 1940's and 1950's many Canadians built their homes co-operatively. Once the houses were finished, the building co-op was dissolved, and the members were given freehold ownership of their home.

CCDC 2: The CCDC 2 is the Canadian Construction Association's standard construction contract. You will want your lawyer to make changes to the CCDC 2 before you sign it.

Construction Management: The co-op pays a builder a fixed fee to organize the construction. The co-op enters into a contract with each trade, and has to pay all the trades each month. With a good construction manager, and a good architect, construction management can save lots of money. If you run into trouble, it is a disaster because the co-op is legally the builder.

Equity: Equity is the difference between the money the bank is willing to lend, and the total cost of the project. When an individual buys a house, the equity is called the down-payment. When a company buys a building, their equity is considered an investment.

Equity Co-op: Members own their units, and can sell them on the open market when they leave. There is no limits on how much a unit can be sold for, but the purchaser has to be accepted as a member. (An equity co-op in New York City turned down Richard Nixon's membership application when he tried to buy a unit.)

Invitational Tender: The co-op invites only the builders it believes will do a good job to bid on the project.

Limited Equity Co-op: An equity co-op which limits the amount of profit a member makes when they sell their unit.

Open Book Tender: This is a blend of construction management and a fixed price contract. The builder gets a fixed fee. The builder tenders the work, and shows all the bids to the co-op. The builder signs a fixed price contract with the co-op. The contract includes the builder's fee, contingency, and contracts with the trades. The co-op pays the contractor monthly, and the contractor pays the trades. The contractor can make extra money if the contingency is not used.

Large Loan Co-op: This is another name for an equity co-op.

Member Loans: Many co-op require their members to make a loan to the co-op when they move in. The member loan is very large in an equity or limited equity co-op. In a non-profit co-op the member loan is usually one month's housing charge. (Some equity co-ops sell shares to raise equity instead of using member loans.)

Non-Profit Co-op: In a non-profit co-op, the members can't sell their units. Rather they transfer their unit to the co-op when they leave, and the co-op chooses the next member. The member loan is usually one months' housing, and the member gets their member loan back, without interest, when they leave.

Negotiated Contract: This is where you sit down with a builder you can trust and negotiate a contract, which is fair to both sides. You usually do this before the drawings are finished to allow the builder to make suggestions about ways to save costs.

Public Tender: The tender to open to all builders. The drawings and specifications must be perfect, or you are going to have a lot of extras..

Turnkey: This is like buying a new house. You pay the builder when the project is finished. You use his architect and have minimal involvement in the design and construction. The builder takes all the risks, and pays the architect and other development costs. There are no extras.

Working Drawings: Drawings prepared by the architect which can be used for construction.

Appendix III

Development Costs (Budget)

This Appendix sets out some of the costs you will incur when developing a new project.

1. Construction Costs

Construction Costs are a moving target. The market is particularly hot at the moment, and prices are increasing. The costs also vary widely based on the size of the project, the finishing materials, the difficulty of the site etc. The following ranges are a rough guide to costs (in 1998) for preliminary budget purposes.

i) Concrete: \$80 to \$90 per foot.

ii) Wood Frame: Townhouses \$60 per foot
Stacked Units: \$70 to \$75 per foot

iii) Underground Garages: About \$15,000 per parking space.

iv) Overhead and Profit: The construction prices do not include the builder's overhead and profit. Add 5% for overhead and site administration, and 5% for profit. Remember: the profit is also the builder's contingency.

2. Soft Costs

Soft costs are 15% to 25% of the total project costs. The following are some of the soft cost you should think about when you make up your budget.

Fees & Charges

- Land Transfer Tax
- Building Permit
- Park Dedication
- Municipal Levies
- Zoning Application Fees

Consultants

- Architect
- Landscape Architect
- Engineer (structural, mechanical & electrical, noise)
- Appraiser (your appraiser and the lender's appraiser)
- Rezoning Consultant
- Development Consultant
- Lawyer (your lawyer and the lender's lawyer)

Project Costs

- Marketing (publicity, ads, staffing)
- Group Expenses (board and/or committee costs)
- Bookkeeping and Accounting
- Sector Membership Fees and Meetings

Financing

- Interest on Advances
- Mortgage Broker's Fee
- Lender's Application Fee
- CMHC Insurance Fee

Appendix IV

Limited Equity Co-ops

This appendix sets out some of the questions to be considered if you want to set up a limited equity co-op.

Social Goals

Limited equity co-ops have social goals that are an important part of their development program. Some of the goals include:

- The down payment should not be a deterrent to owning a unit. A percentage of the units should have very low down payments (not more than the first and last month's rent for a comparable unit).
- Not everyone wants to own. A percentage of the units should be rental.
- Suitable common space for the members. (This may include a large meeting room and a kitchen, or community gardens etc.)
- Housing should not be a speculative commodity. The sale price of units should be limited in some way.

The cost of meeting the social goals must be considered carefully. Most groups have to make some compromises to make the financing work.

Corporate Form

The project should be incorporated as a non-profit co-op without share capital. Equity can be raised in the form of membership fees and member loans.

Limited equity co-ops may be eligible for membership in the Co-operative Housing Federation of Canada.

Membership Fees

A substantial membership fee of \$500 to \$1,000 should be charged.

A high membership fee allows the co-op to raise capital to cover some of the initial development costs without having to issue shares or solicit member loans. Issuing shares or soliciting loans requires the filing of a prospectus with the Ministry of Finance. Membership fees are not subject to regulation.

Member Equity

Member loans are preferable to share capital. There is no difference in the amount of money which is raised, but with member loans it is possible for the co-op to be a non-profit, and member loans are easier to explain.

The minimum for a member loan is \$2,000 and ideally the loan should be at least \$5,000. The loan should cover the costs of the community's social goals: for instance, if the community facility in a 20 unit co-op costs \$100,000, the member loan should be \$5,000 per unit. In cases of financial difficulty, the

co-op can make provisions to allow a member to pay a smaller loan, or to pay in instalments.

Mortgages

Many co-ops use a blanket mortgage to finance the project. It is often difficult to get financing for a blanket mortgage because the banks appraise the co-op on a rental rather than an ownership basis. The co-op is responsible collectively to pay the mortgage, and the members income and credit worthiness is not considered by the bank.

Some co-ops give their members a long term lease, which is registered on title and can be mortgaged. The banks look at a co-op with leasehold mortgages as ownership. The members arrange their own financing, and the mortgage payment is entirely the responsibility of the member.

In order for the co-op to register the lease, the units must be severed. There are a number of ways this can be done, and the co-op should consult with their lawyer to determine the best way. It is not easy to get a severance, and there may be technical issues which make it impossible for your project to get the severance.

CMHC Insurance

CMHC has indicated verbally that they will insure leasehold mortgages in limited equity co-ops. CMHC insurance will allow first time home buyers to get a mortgage equal to 95% of the appraised value; other purchasers can get a mortgage equal to 90% of the appraised value.

Prospectus

The Co-op will have to issue a Prospectus, also called a Disclosure Statement, advising members and investors about the risks of purchasing units or lending money to the co-op. This document can be quite complex, and needs to be done properly to ensure that the board is not exposed to any legal action.

Limits on Resale

The co-op can use the lease to limit the resale value of a unit. Some groups have decided not limit the resale value, but in most equity Co-ops there is a strong desire to limit the resale price to keep the units affordable and to prevent anyone from flipping the unit and making a quick profit.

There are a number of different ways to structure the resale formula:

- a fixed percentage below the appraised market value of the unit;
- the resale price is the initial purchase price increased by the change in an index (such as the CPI or the average industrial wage);
- a formula which takes into account depreciation, the value of improvements, principal repaid, reserve fund requirements, etc. etc.)

Developing a fair and reasonable resale formula is one of the greatest challenges for a limited equity co-op.

Appendix V

Land Prices/Offers

The co-op should negotiate builder's terms when they buy land. Builder's terms are 5% down with the offer, a further 5% when the land closes and the balance when the house sells. The Vendor only receives the balance when the purchaser acquires the house, if the house is unsold the Vendor has to wait until it sells to get any money. The 90% balance is a vendor-take-back mortgage which is interest free for one to two years. The vendor-take-back mortgage is postponed to construction financing.

Currently raw land for apartment condominiums is selling for about \$10,000 to \$15,000 per unit in downtown Toronto. Land for townhouse condominiums is selling for between \$300,000 and \$400,000 per acre (plus levies) in Mississauga and Scarborough. [This works out to approximately \$40,000 per unit for townhouse land.] Land for freehold houses is selling for between \$2,000 and \$4,000 per linear foot (including levies) in Metro Toronto. [This works out to between \$80,000 and \$160,000 for a 40 foot lot.]